

BEFORE THE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petitions for Redetermination
Under the Tax on Insurers Law of:

WAUSAU BUSINESS INSURANCE COMPANY
WAUSAU UNDERWRITERS INSURANCE CO.
EMPLOYERS INS. CO. OF WAUSAU

Appearances:

For Petitioners:	Eric Miethke, Attorney at Law Richard D. Martland, Attorney at Law
For Department of Insurance:	Larry C. White, Senior Staff Counsel
For Excise Taxes Division:	Trecia M. Nienow, Tax Counsel
For Appeals Division:	Jeffrey G. Angeja, Tax Counsel III

MEMORANDUM OPINION

This opinion considers the merits of three petitions for redetermination for the period January 1, 1997 through December 31, 1997. At issue is whether petitioners' gross premiums subject to tax under Revenue and Taxation Code sections 12201 and 12221 include deductible reimbursements received from employers for workers' compensation policies issued in California.

Under California law, all insurance companies (except those transacting title insurance and ocean marine insurance) are required to pay an annual tax based on the amount of gross premiums received less premiums returned, for business done in this state. (Rev. & Tax. Code, §§ 12201 & 12221.) Petitioners here are insurance companies who must pay the annual tax based on their gross premiums, less returned premiums.

The dispute in these petitions centers on the definition of "gross premiums" under Revenue and Taxation Code section 12221 and Insurance Code section 11735, which became operative January 1, 1995. Insurance Code section 11735, subdivision (e), changed the law for

insurance companies issuing workers' compensation policies in California by allowing for deductibles, whereas before 1995, deductibles were only allowed for other forms of insurance (e.g., medical, auto, etc.). Thus, before 1995, an employer had to either be fully self-insured or obtain a workers' compensation insurance policy without any deductible.

This change in the law enabled workers' compensation insurance companies to offer to their insureds (employers) policies with deductibles. Since an employer with a deductible policy would then pay claims and benefits within the deductible layer, this reduced the amount of claims the insurer ultimately paid.

However, because the Legislature was also concerned that employers could fail to pay claims or benefits within the deductible (e.g., due to insolvency) or pay claims late (thereby disrupting benefits to injured workers), it adopted subdivision (e)(2) and (e)(3) of Insurance Code section 11735. To protect against the employers' inability (or unwillingness) to pay claims within the deductible, subdivision (e)(2) requires the deductible endorsement to include a provision that specifies "that the nonpayment of deductible amounts by the policyholder shall not relieve the insurer from payment of compensation for injuries sustained by the employee during the period of time the endorsed policy was in effect." To ensure timely payment of claims, subdivision (e)(3) requires the deductible endorsement to include a provision that provides "that notwithstanding the deductible, the insurer shall pay all the obligations of the employer for workers' compensation benefits for injuries occurring during the policy period."

From 1995 forward, when petitioners reported and paid their insurance tax liability on gross premiums, they did not include in their reported gross premiums any deductible reimbursements received from employers who were issued workers' compensation policies. On or about February 25, 2002, the Department of Insurance (DOI) sent a notice to all insurance companies licensed to issue workers' compensation policies in California. In substance, the notices informed insurers that deductible reimbursements received from insured employers under Insurance Code section 11735, subdivision (e)(2) and (7), are considered gross premiums subject to tax under Revenue and Taxation Code section 12221. DOI then recommended that the Board issue, and the Board issued, deficiency assessments to petitioners and all other insurance companies writing workers' compensation policies in California, for 1997 forward. (Deficiency assessments for 1995 and 1996 were barred by the applicable statute of limitations (see Rev. & Tax. Code, § 12432).)

Petitioners question both DOI's seven-year delay before sending out the above-referenced notices, and whether deductible reimbursements are part of gross premiums subject to tax. The DOI asserts that because Insurance Code section 11735, subdivision (e) makes the carriers responsible for payment of all obligations of the insured employer for injuries occurring during the policy period, the employer's payment of its deductible is legally a payment of premium and thus taxable.

OPINION

We conclude that the deductible reimbursements are not included within the measure of the gross premiums tax. Subdivision (e)(3) of Insurance Code section 11735 expressly states that the amount paid by the carrier on behalf of the employer is “an advancement of funds” that creates a “legal obligation for reimbursement” by the employer. Further, the Legislature provided that this statutory mechanism is intended to reduce premiums in that subdivision (e)(5) of section 11735 requires that each policy include “[a]n explanation of premium reductions reflecting the type and level of the deductible will be clearly set forth for the policyholder.”

Thus, we conclude that subdivision (e) of Insurance Code section 11735 was not intended to render the deductible an insurance risk of the insurance company, but that the deductible portion of the arrangement was instead intended as a risk assumed by the employer for which the employer would be entitled to a reduction in premium. We therefore conclude that the insured employer’s reimbursement to the insurance company for the amount of benefits paid by the insurance company within the deductible is not the payment of gross premiums subject to the insurance gross premiums tax, but instead is the repayment of amounts advanced to the employer by the insurance company. Accordingly, we grant the petitions for redetermination.

Adopted at Sacramento, California, on December 18, 2002.

John Chiang _____, Chair

Johan Klehs _____, Member

Dean Andal _____, Member

Claude Parrish _____, Member

Kathleen Connell _____, Member